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Business in Brief

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THE CHASE MANHATTAN BANK

Business activity has leveled off — on an exceedingly high plateau. Some lines, like capital goods, have exhibited extraordinary strength. Credit has remained tight and interest rates are moving higher. However, adjustments are underway in other areas, chiefly in autos and housing. As a result of these cross-currents:

¶ Industrial production has held steady at about its December high;

¶ Total employment is down slightly, though unemployment is still very low (2.8 million in March);

¶ Gross national product has shown little change since the fourth quarter of 1955.

The question now is: Will business activity, after a period of consolidation, move into a period of renewed growth?

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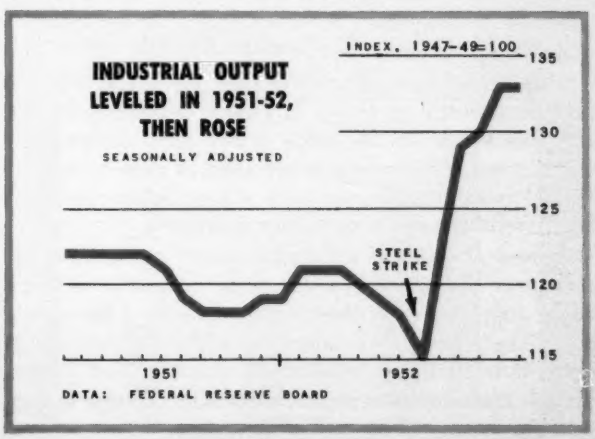
Some observers argue that a leveling out in business activity is almost always followed by a general decline. In fact, the leveling is supposed to cause the decline: sales fail to come up to expectations; then inventories must be cut back; and plant and equipment investment follows suit.

Actually, however, historical experience belies this theory. In 1951 and 1952, to use a recent example, business paused and then resumed its upward climb. The first half of 1947 was also a period of consolidation followed by expansion.



Great underlying strength is the main feature of the current situation. Expenditures on autos and housing have dropped some 12% from their peak. Yet over-all activity has merely leveled out.

To be sure, some further adjustments may lie ahead. Auto inventories are 35% above a year ago while sales are running 11% lower. There is some evidence that steel consumers are building inventories at an unusually rapid pace. However, no widespread inventory correction — like those in 1937, 1949 or 1953-54 — seems in the offing.

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Moreover, the basic propelling forces in the economy seem to be gaining vigor.

¶ The recent SEC-Commerce survey shows that business plans to invest 22% more in new plant and equipment this year.

¶ The Federal Reserve survey of consumer finances shows that people are confident about their financial outlook.

¶ A number of signs point to improvement in the housing outlook.

¶ Government expenditures are rising as more will be spent this year on roads, schools, foreign aid and defense.

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Consequently, it should be possible to negotiate the current readjustments — like those of 1951-52 and early 1947 — successfully.

Indeed, some striking parallels exist between the situation in 1951-52 and that today.

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Then, as now, the major areas of adjustment were in autos, housing and inventories. But plant and equipment investment held firm in 1951-52 and government expenditures rose. So the leveling was followed by a general advance.

There are, to be sure, some differences between the current situation and 1951-52. Even so, the parallel emphasizes the point that business can sustain considerable adjustments so long as the basic underpinnings of the economy are strong, as they appear to be today.

MONEY MARKET

Restraint Continues

Credit has remained tight, despite the leveling in over-all business activity. Business loan demands on banks have been strong, while Federal Reserve policies have kept bank reserve positions under pressure. The result: Interest rates have moved up.

Shifts in Credit Demand

Total demand for credit and capital has increased less rapidly this year than in the same period of 1955. However, the character of credit demand has been shifting in a manner that has sustained the demands for bank loans:

- The net demand for instalment and mortgage credit has eased considerably, reflecting the slowdown in auto and housing sales and the rising curve of repayments on outstanding debts.
- Business loans turned down less than seasonally early this year and then took an unusually sharp rise in March. Part of the March increase is explained by the high level of corporate tax payments.

Bank loans to seasonal borrowers are declining, and sales finance companies are paying off loans. But the rise in business inventories and the strong upsurge in plant and equipment expenditures has kept loan demand high.

Pressure on Bank Reserves

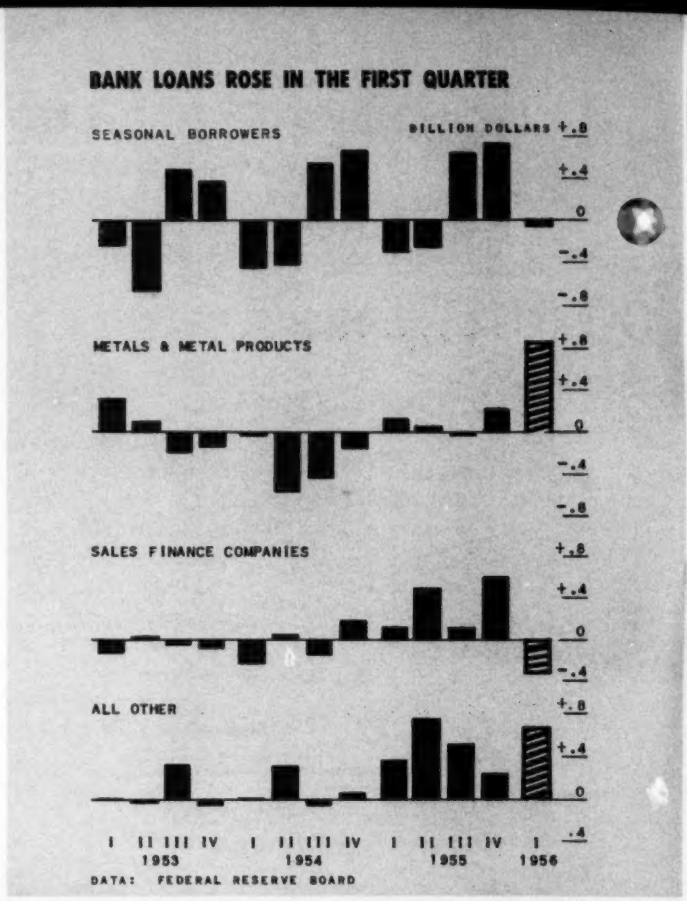
The reserve position of banks has been under pressure for over a year. The rapid rise in business activity during 1955 led to, and was supported by, a rise of $11 billion in bank loans.

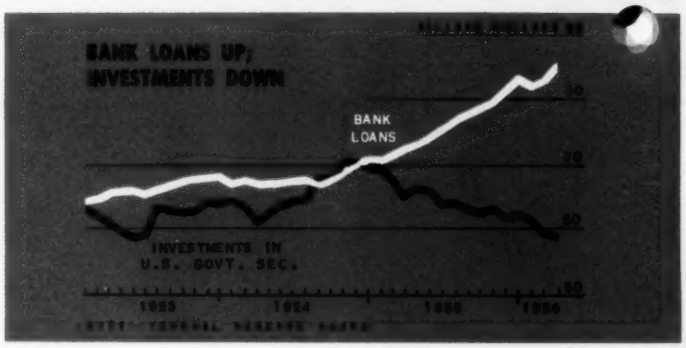
Because of the Federal Reserve's policy of restraint, the rise in bank deposits was limited to $4.3 billion last year. So commercial banks had to sell some $7 billion of Government securities and borrow from the Federal Reserve to meet loan demands.

Free reserves of the banking system (excess reserves minus borrowing from the Federal Reserve) dropped from $400 million in January 1955 to $100 million in July. Then free reserves moved to a negative figure of $200-$500 million during the second half.

So far this year the Federal Reserve has held net borrowed reserves at a level of about $300-$500 million. Rediscount rates were increased on April 12 th to 3% by several of the Federal Reserve Banks and to 2¾% by the remaining reserve banks. Thus, the authorities are continuing to follow a policy of restraint.

The combination of rising loan demand plus continued pressure on bank reserves has helped push important segments of the interest rate structure upwards. Thus, the rise in rediscount rates was followed by an increase in the minimum rate charged by banks to selected commercial borrowers from 3½% to 3¾%. In addition banks





are being more selective in their lending and in many instances are requiring the retention of larger deposit balances against loans.

Future developments in monetary policy will depend most importantly on trends in general business activity. By definition, a flexible credit policy must exercise restraint when the economy is operating at close to capacity and relax the pressure only when a clear need for easier credit conditions can be demonstrated.

However, continued restraint in credit markets is not necessarily inconsistent with some expansion of the money supply to meet the legitimate needs of the economy. Thus, bank loan expansion might be supported partly through the liquidation of securities and partly through increased reserves made possible through larger bank borrowing or Federal Reserve action.

THE SCIENTIST AND ECONOMIC GROWTH

The Impact of Science on Recent Gains in Productivity

One of the most dynamic growth markets in the United States today is the market for scientists and engineers.

- The number of scientists and engineers at work has grown from 575 thousand in 1947 to nearly 900 thousand today.

- At the same time, salaries paid to scientists and engineers have been rising even faster. The average college graduate in engineering starts work at about $400 a month today; he received less than $250 in 1947.

- Furthermore, the market is growing. For example, we graduate about 23,000 engineers today. We need an estimated 40,000. We graduate about 400 nuclear scientists a year. We need at least 1200.

The Scientist and Economic Growth

This spectacular growth in the demand for scientists holds great promise for the future. For science today may well be the most important single cause of economic growth. During the postwar period, for example:

- Spending on research has grown on the average 10% a year.

- Our stock of scientists and engineers has grown 6% a year.

- And output per man-hour, as a result, has grown nearly 3% a year – which is considerably above the long-run average of 2.2%.

During the 1930's, some observers feared that the great wave of technological innovation of the 19th century had spent itself and that stagnation had set in. Recent experience does not bear out that dismal view. If anything, the opportunities for new inventions, new innovations and new techniques today are probably accelerating.

The Bottleneck in Education

However, the demand for scientists has been increasing faster than the supply of qualified people. Thus we are running into a bottleneck in education – so we may not be able to take full advantage of the potentials for technological development.

What is more, there is disturbing evidence that we are falling behind the Russians in training technicians.

- Only 16% of our college and university students major in science or engineering today (a drop of more than a quarter since 1950). In contrast, more than 35% of all Russian students are science majors.

- This difference in emphasis is even more exaggerated in secondary education. Less than half of our high schools give courses in physics and chemistry. In Russia, more than 40% of *all* class instruction is devoted to science.

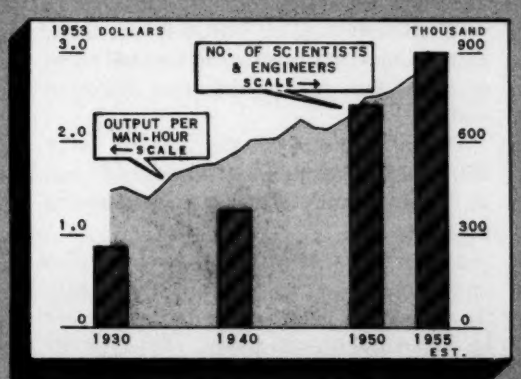
Consequently, the Russians are turning out 30,000 more engineers and scientists today than the United States. And the gap is widening.

Public Policies Toward Education

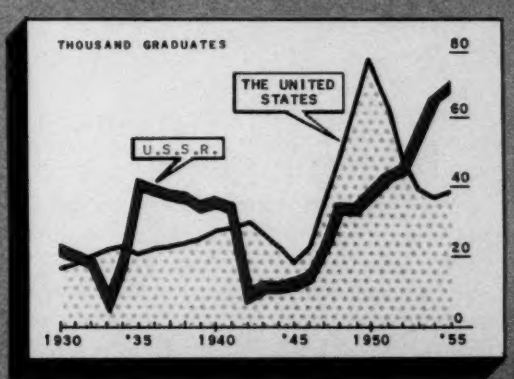
As a partial answer to these growing needs, the President has recently requested $5 million for an experimental program, for improving science teaching in our schools and colleges. He has asked for another $13 million to increase support of basic research.

All of these are steps in the right direction. Continued growth in scientific education is essential for continued growth of the economy as a whole.

SCIENTIFIC RESEARCH MEANS INCREASED PRODUCTIVITY



...BUT THE SOVIETS ARE PASSING US IN TRAINING SPECIALISTS



DATA: NATIONAL SCIENCE FOUNDATION, OFFICE OF EDUCATION & JOINT COMMITTEE ON THE ECONOMIC REPORT

EARNINGS AND

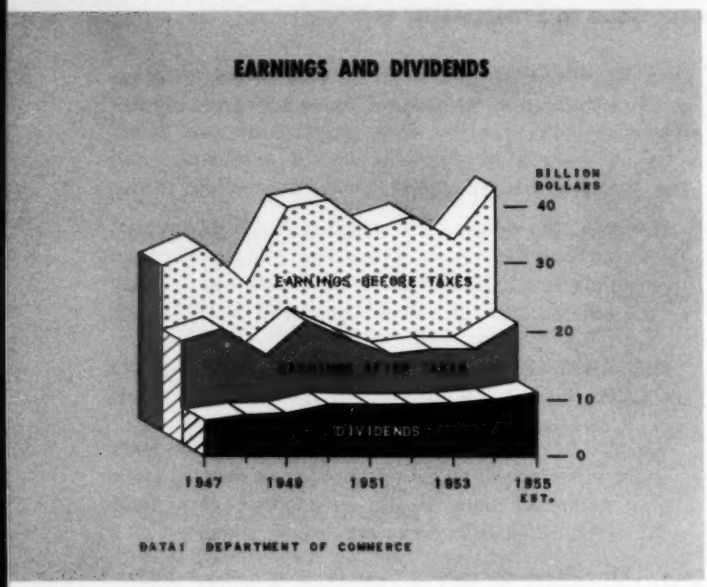
Short-run Prospects Point to Some Leveling Of

I SHORT-RUN PROSPECTS

CORPORATE EARNINGS AND DIVIDENDS in 1955 topped all previous records. Earnings after taxes rose to $21.5 billion – a 27% rise over 1954. Dividends, at $11.1 billion, were up 11%.

A sharp spurt in sales following the 1954 recession caused most of the rise in 1955. Since we have now reached capacity in many lines, this rate of increase cannot be sustained.

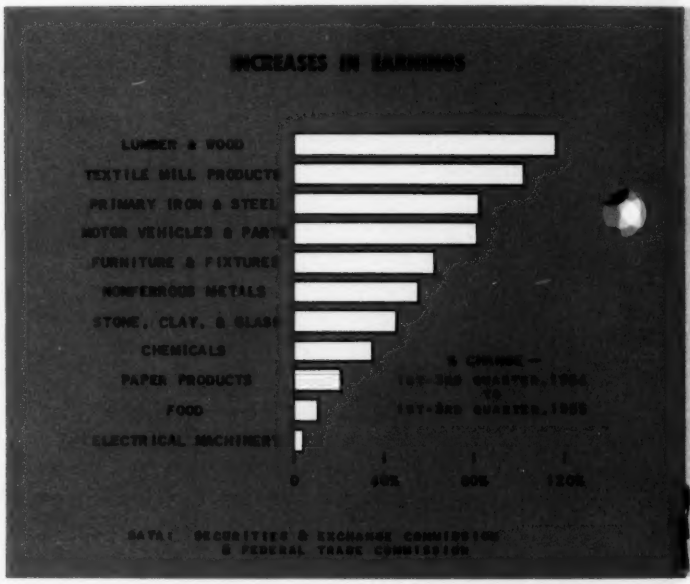
Earnings, as a result, have been leveling out in recent months and should show little change for the rest of 1956.

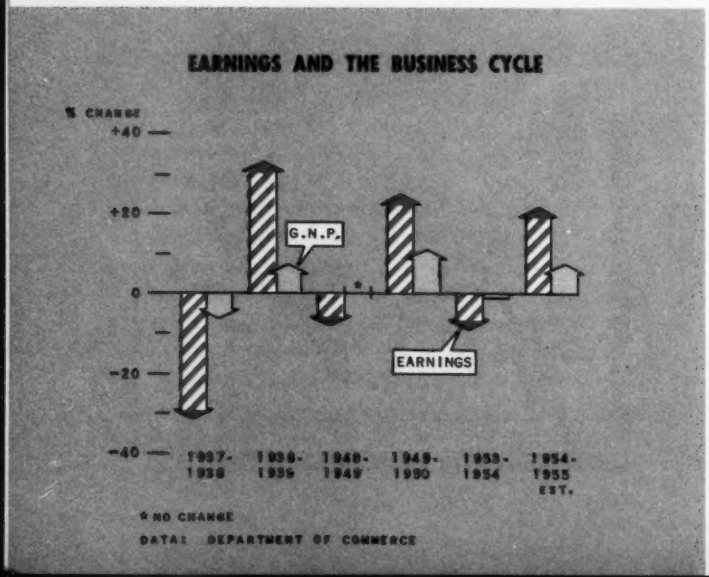


THE SHARPEST RISE in earnings in 1955 occurred in hard goods industries where sales vary widely with the business cycle.

- Earnings in lumber and wood, for example, were up 117% last year as a result of the building boom.
- Earnings in iron and steel were up 83%. Record auto sales boosted auto profits 82%.

EARNINGS IN SOFT GOODS also rose, but to a lesser extent. Earnings in the food industry, for example, increased 11%, while apparel gained by 27%.





EARNINGS AS A WHOLE rose faster than business last year – and also fell faster in 1954. This follows the usual historical pattern.

During a recession, sales drop off faster than costs. Thus profits (the residual) can sink quite sharply. During a recovery the reverse is true.

AT FULL CAPACITY, however, sales and costs usually rise together. Profits may then level out. We are operating at close to full employment today. Thus profits have tapered off.

D DIVIDENDS

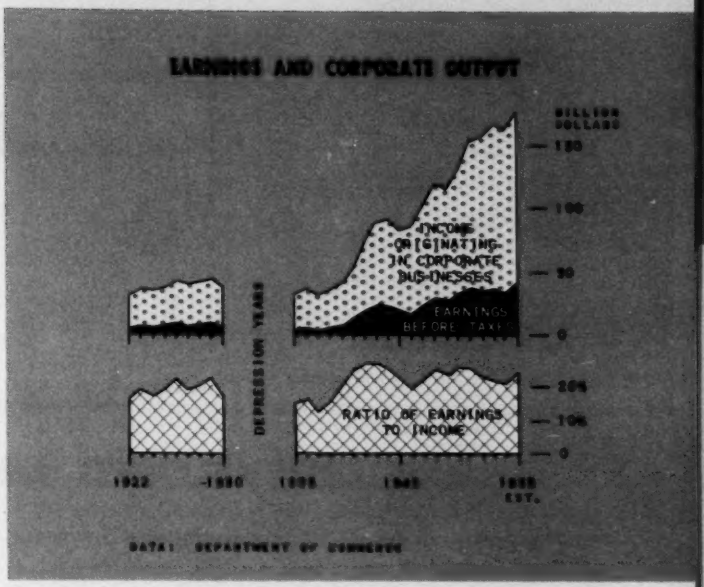
ing Off; Long-run Prospects Are Good

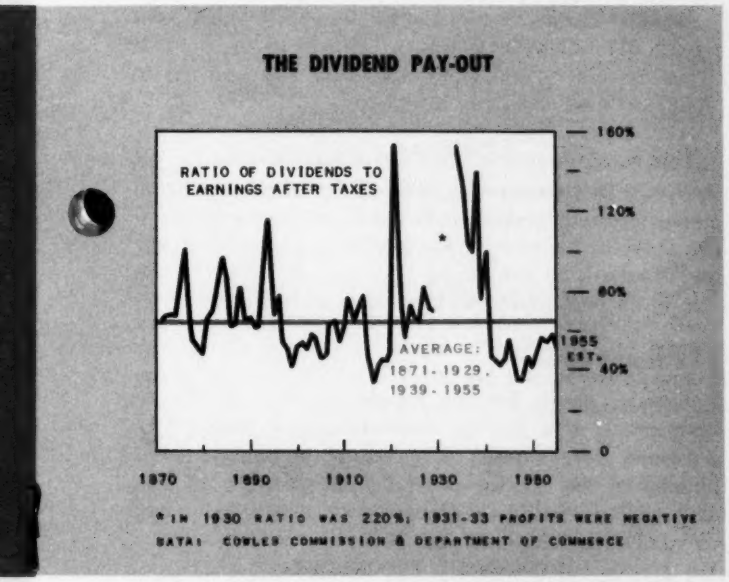
II LONG-RUN PROSPECTS

AS CAPACITY CONTINUES TO EXPAND over the longer run, however, earnings should also rise. In fact, developments in the next 10 years could lead to a somewhat faster growth in earnings than in the economy as a whole.

- EARNINGS BEFORE TAXES (apart from their cyclical swings) have shown remarkable stability as a share of corporate output.
- TAXES may ease off in the next decade if Government revenue needs permit.

If so, earnings after taxes may grow faster than total output.



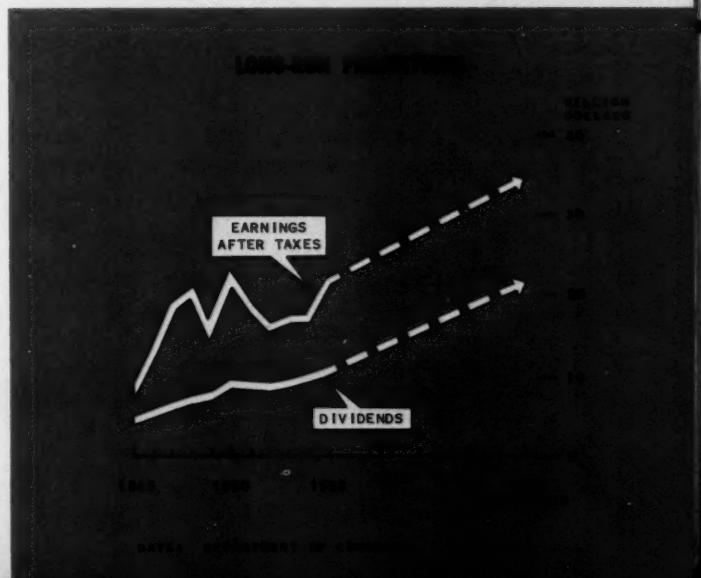


THE DIVIDEND PAY-OUT may increase too. Corporations paid 52% of their profits after taxes in dividends last year. That compares with a long-run average of 64%. So there is room for moderate increases in dividend payments.

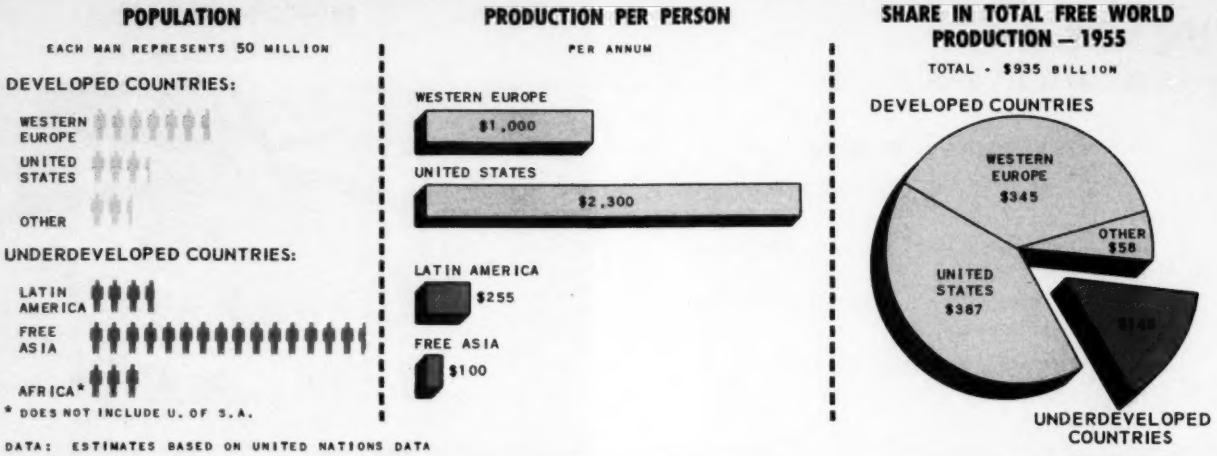
IF THE ECONOMY continues to grow at its post-war rate, therefore:

- Profits after taxes could total $35 billion by 1965.
- And dividends could reach $22 billion.

Thus, the long-term trend of both earnings and dividends should be upwards, though year-to-year swings will continue to be sharper than those of the economy as a whole.



HOW THE ECONOMIES OF UNDERDEVELOPED COUNTRIES AND DEVELOPED COUNTRIES COMPARE:



DATA: ESTIMATES BASED ON UNITED NATIONS DATA

UNDERDEVELOPED AREAS: The U.S. Stake in Their Growth

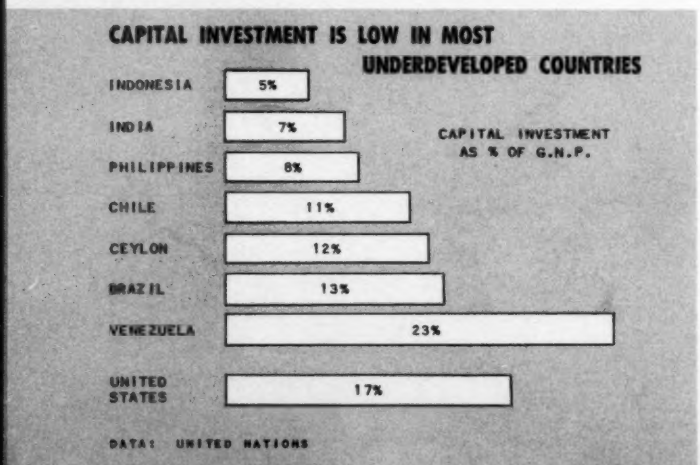
The U.S. and other industrial countries have an important interest in the progress of the underdeveloped areas. Trade between industrial and underdeveloped areas is growing in importance. Moreover, as President Eisenhower said recently, we cannot hope to remain a "paragon of plenty" amid a world of poverty.

The underdeveloped areas also have received growing attention from the Soviet Union. In the past year the Soviets have extended over $500 million in long-term credits to such areas. With expanding industrial capacity, it appears likely that the Soviet Union will become increasingly active in these markets.

In view of these facts, it is pertinent to examine just what the industrial countries of the West are doing to encourage the economic growth of the underdeveloped areas.

First it is clear that the underdeveloped areas are already receiving very substantial support from the Western Countries.

- Long-term investment funds from the U.S. and Western Europe have been flowing in at a rate of $1.1 billion a year.
- U.S. contributions for foreign economic assistance are scheduled to reach $900 million in fiscal 1956.



DATA: UNITED NATIONS

- The industrial countries buy 73% of the exports of the underdeveloped countries and supply 75% of their imports. This trade supplied the underdeveloped areas with $17 billions of goods in 1954, including most of the machinery and equipment that was installed to support their economic growth.

This is an impressive record of economic support. Yet the pace of economic progress in the underdeveloped areas in recent years has fallen short of the advance elsewhere in the free world. The wide gap between living standards in developed and underdeveloped areas has, in all probability, widened somewhat further.

Investment Low

A major reason for this widening is that capital investment is still low in underdeveloped areas. The economic development of a country is importantly a function of the amount of production plowed back into new capital — roads and railways, factories and farm equipment, power plants and mines.

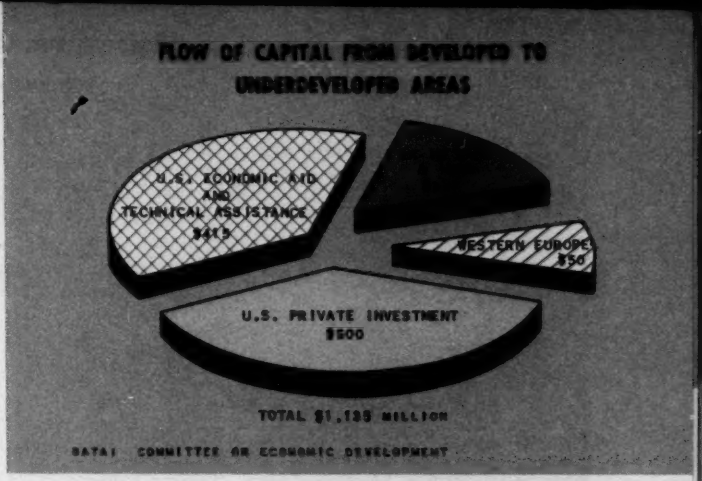
- In many nations in Asia, the Middle East and Africa the current rate of investment is around 6-7% of national output — barely sufficient to keep pace with population growth.
- The investment rate is higher in Latin America. But the rate of population growth is higher, too. It averages 2½% a year. So even with a 3% per year rise in total production, living standards have been rising only about ½% of 1% annually since 1951.

The shortage of investment capital is by no means the sole factor holding back economic progress in the underdeveloped areas. There is a vast shortage of trained managerial and technical personnel. The social and political atmosphere in many countries contains elements that inhibit investment. And there are cases where

domestic inflation or economic controls and policies distort the pattern of investment.

All these difficulties magnify the risks inherent in U.S. private investment in the underdeveloped areas. At the same time, the rate of return on foreign investment has not been significantly higher than that on investment in the U.S. (with, of course, some notable exceptions).

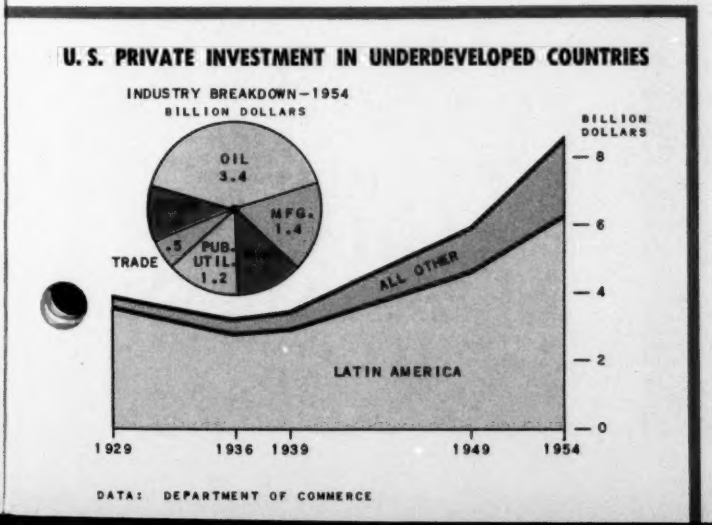
Consequently, the flow of U.S. private investment into other countries has not been large relative to our potential. The total has averaged less than 1% of our national income (and the amount going into underdeveloped areas accounts for 40% of the total). In contrast, Great Britain invested more than 4% of her national income abroad from 1865 to 1914.



Dimensions of the Problem

In view of the problems inherent in foreign investment in today's world, it is most unlikely that the U.S. will ever match the ratio attained by Britain in her heydey. The significant point, however, is that we can make a substantial contribution to the economic development of underdeveloped areas without having to earmark anything like 4% of our national income for this purpose.

- Our $400 billion economy is almost three times the size of the total economies of underdeveloped nations. If you add the other industrialized economies to the U.S., the ratio is more than 5 to 1.
- The underdeveloped areas are now investing roughly $13 billion each year. (All external sources finance $1.1 billion or 8½% of this total.)
- A major part of the increase in investment needed to support the growth of the underdeveloped areas must be generated locally. The bricks and mortar, the highway fill, and most of the manpower embodied in a nation's investment capital usually cannot be imported economically.
- Thus, an increase of $1-1½ billion a year in the flow of investment from industrialized to underdeveloped nations might well produce spectacular results. That amount is about all most experts think could be mobilized or used effectively in the next few years.



Lines of Approach

What can be done to encourage investment in the underdeveloped areas? Primary responsibility lies with the receiving nations. To encourage a substantial inflow of investment funds they must adopt responsible policies which will create a favorable climate for investment.

Nevertheless, there are a number of things the U.S. can do to stimulate private foreign investment. For example, the Administration has proposed a 14 point reduction in the income tax on income earned abroad. In addition, the Government seeks to work out investment treaties that will assure fair treatment of American foreign investors.

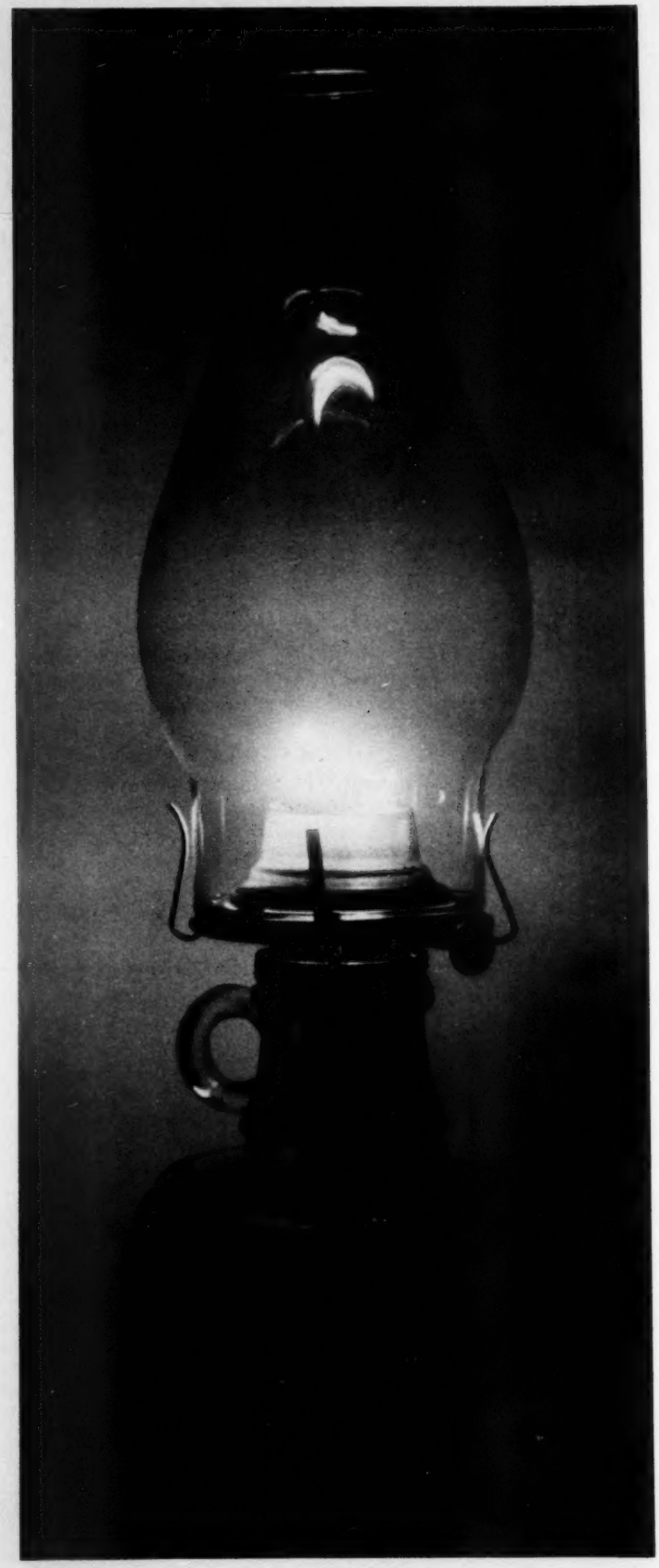
An important part of the foreign capital needed by underdeveloped areas is for transportation and other basic facilities – fields that do not attract private investment under present conditions. Thus, the programs of the Export-Import and World Banks operate to supplement private investment.

The two Banks are now providing net credits of about $170 million a year to underdeveloped areas. The total will probably increase as more sound projects are developed by the countries involved.

U.S. Interest

The U.S. has a big stake in the future of the underdeveloped areas. We must rely – increasingly – on these areas for many of the raw materials necessary to support our own economic growth. Our major allies – Britain, Western Europe, Canada and Japan – depend even more heavily on trade with the underdeveloped areas.

What is more, the vast upheaval now under way in the underdeveloped areas promises to have a profound impact on the entire world. By supporting the accelerated economic development of these nations we can help lay the groundwork for the evolution of free and democratic institutions. Economic development does not guarantee these results, but it does seem to be a prerequisite for the attainment of our objectives – rising living standards, expanding world trade and the growth of the democratic tradition.



Blown out by Mr. Edison and friends!

Read how banks helped the electric light illuminate all America

One idea made the kerosene lamp obsolete.

But it has taken billions of dollars to replace it, and much of the money has been provided by loans from commercial banks. The story goes like this:

After Mr. Edison and his private backers proved the new incandescent lamp practical, progressive men the country over saw that electric light could be sold cheaply to all the people.

From the first, the job was too big—too costly—for any individual to tackle. So groups of citizens got together and formed light and power companies.

Then, as the industry expanded, even the most prosperous companies lacked enough hard cash for generating more power, stringing up miles of new wire, and delivering current to millions of new consumers. So they turned to the nation's banks for assistance.

In less than half a century, America was able to put the kerosene lamp on the museum shelf.

But there is nothing exceptional about this example of banking's contribution to progress. The simple fact is that it is banking's job to put the community's idle money to work wherever and whenever bankers find opportunity for profitable enterprise.

Money at work in utilities or any other industry results in jobs for men and women, returns for investors, and a high standard of living for the American people.

The Chase Manhattan Bank, first in loans to American industry, is proud of the part it is playing in our nation's progress.

THE CHASE MANHATTAN BANK

(MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION)